

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interviews of Alan Langworthy on April 19, 2006 and June 28, 2006

DATED: July 6, 2006

On April 19, 2006, Michael Schachter and Michael Shapiro, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Alan Langworthy at the City Administration Building, 202 C Street, in San Diego, in a conference room on the third floor. Johnny Giang and Tammie Davis from KPMG also attended the interview. Mr. Langworthy was not represented by counsel.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Alan Langworthy, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Mr. Schachter informed Mr. Langworthy that we are counsel to the Audit Committee and do not represent him or any employee. He advised Mr. Langworthy that the interview may be considered attorney work product and confidential, but the decision of whether to keep it confidential will be made by the Audit Committee in the best interests of the City, not by Mr. Langworthy personally. Mr. Schachter said we will create a report which may contain statements of interviewees, and this report will likely be provided to KPMG and ultimately released to the public. He said government agencies may view the report and be provided with additional information so it is important to be truthful and accurate.

Background

Mr. Schachter asked Mr. Langworthy to describe his professional background. Mr. Langworthy stated that he started working for the City of San Diego in 1977 as a chemist in the Water Utilities Department. He then became a Supervising Chemist and later a Senior Chemist working in the wastewater research section. He later became Deputy Director of the Water Utilities Department in 1986 and was in charge of wastewater plants and labs. He worked on obtaining an EPA waiver from secondary treatment for Point Loma. He also worked on the conversion at Point Loma from primary to advanced primary treatment and on monitoring compliance with all permits. He then became Deputy Director of the Metropolitan Wastewater Department ("MWW"), where he works on environmental monitoring and technical services.

Mr. Schachter asked Mr. Langworthy to explain to whom he reported. He said that from 1986 to 1993 he worked for Mylan Mills, Jr., and then David Schlesinger (Director of

MWWD) when he became Deputy Director of the Wastewater Department. He now reports to Scott Tulloch (Director of MWWD).

Wastewater Primer

Mr. Schachter asked Mr. Langworthy to provide a brief primer on sewage treatment. Mr. Langworthy said that North City came online in 1997-1998 and South Bay came online in 2000. North City does secondary treatment, which means after primary treatment (skimming floatables off the top of the wastewater) and after advanced primary treatment (adding chemicals to congeal any solid particles), bacteria is cultivated that eat the organics in the wastewater and eliminate them. There are different standards for removal depending upon how the wastewater will be used. Organics "putrify" and decompose. In the process, they absorb oxygen. If bodies of water contain organics, the organics absorb the oxygen in the bodies of water. Thus, the reason to remove organics is to make sure bodies of water do not become deoxygenated, thereby preserving the environment. The Clean Water Act sets the standard for all bodies of water but a modified permit is available, which San Diego obtained.

David Schlesinger negotiated the waiver for Point Loma. Schlesinger agreed to use 58% for BOD (biological oxygen demand; *i.e.*, organics), which was the best removal rate that Point Loma had ever accomplished. That 58% figure became part of the Ocean Pollution Reduction Act of 1994 ("OPRA") legislation requirements. North City pretreats for part of the flow that goes to Point Loma so Mr. Langworthy asked the EPA if the City could get credit at Point Loma for the BOD that North City removed. The EPA agreed. Thus, since North City eliminates 2% of BOD, Point Loma only has to remove 56%.

EPA Waiver

Mr. Langworthy was shown Exhibit 1, a February 4, 2000 email from Susan Hamilton to Ted Bromfield, George Loveland, Dave Schlesinger, Alan Langworthy, and Stuart Wells re: "Mayor's Talking Points" and attaching "Talking Points for Mayor Golding for Call to Congressman Filner." Mr. Schachter asked Mr. Langworthy to explain what is being discussed in this document. He responded that by July 1, 1988, the City had to apply for a waiver from secondary treatment and did so. In 1987, the Council wrote a letter to the EPA, against staff advice, that said the City was going to secondary treatment and did not need a waiver. The Council later learned the cost of secondary treatment would be \$2-\$3 billion and asked for special legislation, OPRA, which was implemented in 1994 and allowed waivers. The City asked Congressman Filner for special legislation to change the OPRA legislation to reduce its requirements.

Mr. Langworthy was shown Exhibit 2, an April 19, 2001 email from Bill Hanley to Dennis Kahlie, KumarPN@bv.com, Chris Toth and Alan Langworthy re: "Fwd: Cost of Service second edition," attaching an April 18, 2001 email from Alan Langworthy to Chris Toth and Bill Hanley re: "Cost of Service second edition," attaching a document entitled "Cost of Service Study Questions second edition." He said that he probably prepared it.

Golden Watchdog Award

Mr. Langworthy was shown Exhibit 3, a February 26, 2003 email from Alan Langworthy to Dennis Gibson re: "Golden Watchdog for waiver," and attaching a document entitled, "Approval for a modified permit for the Pt Loma Wastewater Treatment Plan." Mr. Schachter asked Mr. Langworthy to explain the Golden Watchdog Award. He responded that the Golden Watchdog Award was an award given by the taxpayer association for looking out for the best interests of taxpayers. The waiver from secondary treatment saved the City billions of dollars and, therefore, the City applied for the award.

Strength Based Billing

Mr. Langworthy was shown Exhibits 4, 5 and 6. Exhibit 4 is a December 14, 1994 memo from Dave Schlesinger to Distribution List re: "Support Requirements for Strength-based Billings for the Participating Agencies." Exhibit 5 is an April 5, 1995 memo from Hedy Griffiths to Alan Langworthy via Charles Mueller re: "Selection of COD v. BOD as Basis for Strength-based Billing of PA's." Exhibit 6 is an April 13, 1995 memo from Alan Langworthy to Hedy Griffiths via Charles Mueller re: "Selection of COD v. BOD as Basis for Strength-based Billings of PA's." Mr. Schachter asked Mr. Langworthy to explain strength-based billing and its implementation by the City. Mr. Langworthy responded that the City charged only based on flow for a long time, but later included SS and then went to strength-based billing ("SBB"). SBB is billing based on the removal of BOD and COD (chemical oxygen demand; *i.e.*, organics). He had weekly management meetings with all deputies regarding SBB. Bill Hanley and Richard Enriquez were involved in SBB. As of June 2004, the City allocated cost based on COD/BOD. Mr. Schachter asked Mr. Langworthy if it was logical for the COD/BOD requirement to apply to the City as well as to the Participating Agencies ("PA's"). He responded that it was logical that the requirement for COD/BOD removal for the PA's also applied to the City. When asked by Mr. Schachter why the PA's implemented COD/BOD first and then the City did, he replied that he did not know.

Mr. Langworthy was shown Exhibit 7, a November 27, 1996 email from SEH@SDDPC.sannet.gov to "Jack, Coleman, Dave S., Alan L, Charles Y, Kelly S, Shari Sacks" re: "Kelco Discount." He said that "Steve" is probably Steve Hogan, the water department manager involved in billings. "Jack" was Jack McGrory, the City Manager. "Yackly" was Charles Yackly, the finance guru for the water department involved in billings. Shari Sacks was in financial management. The metro sewer agencies are the PA's.

Mr. Schachter asked Mr. Langworthy to explain the first item listed in Exhibit 7: "Hedy noted that the STATE is questioning the RIGHT OF WAY charges." He said that right of way involves paying the City a fee for putting pipes in the street. Mr. Schachter asked Mr. Langworthy to explain the third item listed in Exhibit 7 that states that a Cost of Service Study ("COS") is being done and it could result in a new revenue plan. Mr. Langworthy stated that State audits took place to make sure federal grants were spent correctly. MWWD took the lead on the COS initially and adjusted billing for the PA's while doing the COS for City users. Mr. Schachter asked Mr. Langworthy to explain the seventh item in Exhibit 7, that the State has not been contacted about a discount for Kelco. He said Kelco was trying to lower costs and pretreat to get solids out of their wastewater, which resulted in agreements between Kelco and the City. Discussions took place regarding ensuring that Kelco was paying for what they were putting into

the sewer system and no more, no less. Kelco had high-strength dissolved BOD. Mr. Langworthy volunteered that a change in the rate structure would not bring in more revenue. It would only redistribute the costs. He saw drafts of the COS that revealed a major change in capacity charges.

Kelco

Mr. Langworthy was shown Exhibit 8, a July 21, 1997 email from Susan Hamilton to Alan Langworthy re: "Kelco – Forwarded," forwarding a July 15, 1997 email from Coleman Conrad re: "Kelco." Mr. Schachter asked Mr. Langworthy to explain the City's agreement with Kelco being addressed in Exhibit 8. Mr. Langworthy responded that the agreement between McGrory and Kelco involved analyzing the strength of Kelco's discharge and figuring out appropriate charges, and included the City lending Kelco money for process improvements. Mr. Langworthy helped develop a provisional billing rate for Kelco and it would be increased or decreased each year depending upon Kelco's discharge.

Mr. Langworthy was shown Exhibit 9, a November 5, 1997 letter with attachments from Coleman Conrad to Steve Zapotichny, cc'ing Ted Bromfield, Dave Schlesinger, Susan Hamilton, Alan Langworthy, Bill Hanley, Debra Van Wanseele, and Clay Bingham re: "Reduction in Suspended Solids – Change in Sewer Classification." Mr. Langworthy said the document was a verification of the strength of Kelco's flow. Kelco's strength did not match Kelco's billing class so an adjustment was made to reflect that.

Mr. Langworthy was shown Exhibit 10, a December 14, 1998 letter from David McKinley to Bill Hanley ccing George Loveland, Dave Schlesinger, Susan Hamilton, Alan Langworthy, Hedy Griffiths, Monica Ramos, Eric Adachi, Dennis Kahlie, Nicolas Wiseman, Stephen Zapotichny, and Gregory Kurdys re: "Specific Problems with Wastewater Strength-Based Cost Allocation Factors." Mr. Langworthy said it was a "typical McKinley response." Mr. Schachter asked Mr. Langworthy to discuss his reaction to Kelco's response. He said that a new rate structure would radically change billing for Kelco. He reviewed Kelco's response at the time and may have weighed in on parts of it. He did not support Kelco's position. Mr. Langworthy volunteered that no real harm is done to the environment from Kelco's discharge and BOD probably does not hurt the ocean.

Mr. Langworthy was shown Exhibit 11, a September 11, 2003 email from David Schlesinger to JNHarris@sandiego.gov, cc'ing wst@sandiego.gov, Bill Hanley, and axl@sandiego.gov re: "BOD Sewer Charge: Follow-up meeting – Wednesday, September 10, 9:15 a.m...." Joe Harris is a Deputy Director of Wastewater involved with rates. Mr. Schachter asked Mr. Langworthy what "freebies" Kelco was receiving. He did not know. Mr. Schachter asked why Langworthy received this e-mail. He responded that Schlesinger brought him to meetings to counter Kelco's arguments.

Mr. Langworthy was shown Exhibit 12, a May 10, 2004 email from John Kern to Tom Story re: "Fwd: Re: COS." Mr. Schachter asked Mr. Langworthy if he agreed with McKinley's statement. He said that he disagreed with McKinley's statement starting "Until you demand some fact finding from the Manager the problem will continue. I recommend you speak with Alan Langworthy about what actual costs are incurred for TSS and BOD removal to comply with federal obligations. He will verify that, unlike 1994 when the City only had the PLWTP,

the City does not need higher TSS removal at PLWTP in order to attain OPRA requirement of system wide average 58 percent BOD removal rate.” He stated that McKinley is trying to argue that with North City high BOD removal is not needed. In truth, Mr. Langworthy wanted BOD removal to be as high as possible to provide a cushion above the 58% requirement.

Mr. Langworthy was shown Exhibit 13, an October 8, 2004 email from Dennis Kahlie to Bill Hanley, Eric Adachi, Kelly Salt, Mary Vattimo, Ray Day, and Ted Bromfield re: “Info Memo to Mayor and Council – Kelco/ISP Pretreatment Programs.” Mr. Schachter asked Mr. Langworthy to discuss the referenced program. He responded that in June 2004, there was a Council resolution to examine high COD dischargers, including Kelco, to assist them in reducing their costs. Hanley led a group to figure out if Kelco could pretreat COD in Kelco’s wastewater with the City’s support. It was a business-friendly discussion and was brought to the auditors and the attorneys for an opinion regarding its legality. That is where the idea ended.

Mr. Langworthy was shown Exhibit 14 an October 19, 2004 email from Kelly Salt to Bill Hanley re: “ISP/Kelco Pretreatment Programs.” When asked by Mr. Schachter, he said that he did not know the bond covenants to which Salt is referring in Exhibit 14.

Mr. Langworthy was shown Exhibit 15 a July 12, 2005 email from Thomas Zeleny to Scott Tulloch, Anita Noone and Thomas Zeleny re: “Confidentiality Agreement.” Mr. Schachter asked Mr. Langworthy to explain why a confidentiality agreement was created. He responded that the confidentiality agreement was created because during negotiations, Kelco expressed concern that its industrial processes could be compromised by competitors. The agreement attempted to protect those secrets. He received a subpoena, as did others. Kelco asked him for a copy of the subpoena and he provided it to them after he asked Scott Tulloch, Director of MWWD, if he could do so and Tulloch said he could.

Mr. Langworthy was shown Exhibit 16, an August 10, 2005 email from Dennis Kahlie to Alan Langworthy, Hedy Griffiths, Scott Tulloch, Ted Bromfield and Thomas Zeleny re: “Interrogatories for Shames.” Mr. Langworthy volunteered that in the mid-1990’s, there was a joke that Kelco sent a lawyer in to see the Mayor and the lawyer told the Mayor that Kelco was leaving San Diego. According to the joke, the Mayor called Jack McGrory and told him to work with Kelco to keep them in San Diego.

Mr. Langworthy was shown Exhibit 17 by Mr. Giang, a June 2, 1997 email from Dave Schlesinger bcc’ing Alan Langworthy re: “Kelco Sewer Line.” Mr. Giang asked Mr. Langworthy why it appeared that money was provided to Kelco and why “loans” and “unspecified projects” were in quotes. Langworthy responded that he did not know why it appeared money was provided to Kelco nor did he know why “loans” and “unspecified projects” were in quotes. Marcy Steier (Deputy Director of the Water Department) worked on giving Kelco credit for certain things. He believed “unspecified projects” included potable water. Mr. Schachter asked why the loan amount was increased, Mr. Langworthy said he did not know why the “loan” was increased from \$300 thousand to \$1.2 million.

Mr. Langworthy was shown Exhibit 18, an August 14, 1997 email from Ted Bromfield to “RLL”, “CCB”, “CWY”, “AXL”, “wzh”, cc’ing “CC1”, “D5S” and “SCH” re: “Kelco – Reply – Reply.” Mr. Schachter asked Mr. Langworthy why Kelco received a credit instead of a check. He replied that he did not know why Kelco received credit instead of a

check. Mr. Langworthy thought maybe it was because of its impact on the department. He did not think it would change the accounting. He volunteered that a Council resolution provided the money discussed in this email to Kelco. Later in the interview, Mr. Langworthy said that Kelco appeared to make a good faith effort to reduce their discharge. He stated that the \$300 thousand may have been a rebate to Kelco for achieving a reduction in load. Kelco received money for reducing TSS (total suspended solids; the solid particles that are suspended in wastewater and do not settle out) and also for improving their processes, but he believed this money was repaid.

COS Implementation

Mr. Schachter asked Mr. Langworthy to explain why the COS took so long to be finalized and implemented. Mr. Langworthy responded that the COS took "forever" to be finalized and implemented. Schlesinger expressed frustration about the delays. It became a "local joke" that the COS was "going on forever." Schlesinger was a "doer" which contributed to Schlesinger's frustration with the slow pace of the COS. Financial Management drove the COS. At a Council meeting, Councilwoman Frye questioned Tulloch as to when the COS would be released, but Tulloch had nothing to do with it.

Mr. Schachter asked Mr. Langworthy to explain what transpired from November 1997 to November 1998 regarding the COS. He replied that he did not know and had no role in preparing the allocation factors.

Mr. Langworthy was shown Exhibit 19, an August 8, 1997 memo from William Hanley to Coleman Conrad re: "Implementation of Strength Based Billing." Mr. Schachter asked Mr. Langworthy to explain what is being discussed in this memo. He said that Schlesinger was complaining about the fact that the City was not billing based on COD/BOD. Mr. Langworthy stated that from this document, it appeared that Hanley was the driver of the COS, but he thought that Financing Services was the real department driving SBB.

Mr. Langworthy was shown Exhibit 20, an August 27, 1997 email from Corinne Smith to Alan Langworthy re: "Kelco letter," attaching a September 9, 1997 fax from Corinne Smith to Ted Bromfield accompanying an August 25, 1997 letter David Schlesinger to David McKinley. Corinne Smith was involved in billing in the water department. Mr. Schachter asked Mr. Langworthy if he was involved in preparing this letter. He said that he had a role in putting the letter together but it is not his handwriting. Mr. Schachter asked Mr. Langworthy if, by August 1997, he understood that there was a need to implement COD. He responded that by August 1997, he probably understood that there was a requirement for COD, and that it needed to be taken into account in developing sewer rates. He heard about the State requirements regarding organics and heard banter about lots of grant money being at risk and that a revenue plan had to be approved by the State. Hanley, Kahlie, Yackly and Griffiths would have dealt with such issues.

Mr. Schachter asked Mr. Langworthy if he had conversations regarding why the rates were not being changed. He replied that he did not have conversations about why the rates were not being changed. Mr. Schachter asked Mr. Langworthy why the rates were not being implemented. He responded that people were not happy with the COS. He volunteered that the Stakeholders Committee was "going in circles" and David McKinley from Kelco drove people

"nuts." He volunteered that he had vivid memories of McKinley stonewalling the Stakeholders' Group. When asked by Mr. Schachter, he did not otherwise recall political resistance.

City Reaction to the COS

Mr. Langworthy was shown Exhibit 21, an August 10, 2005 email from Scott Tulloch to Darlene Morrow-Truver re: "Fwd: Re: Interrogatories from Shames," attaching an email with attachments from Dennis Kahlie to Dennis Kahlie, Alan Langworthy, Hedy Griffiths, Scott Tulloch, Ted Bromfield, and Thomas Zeleny re: "Interrogatories from Shames." Mr. Schachter asked Mr. Langworthy if Kelco lobbied to keep the COS from seeing the light of day. He responded that he did not know about Kelco lobbying or why the COS never saw the light of day. Mr. Schachter asked Mr. Langworthy if he knew why Deputy City Manager George Loveland recommended that no changes be made. He responded that he had no explanation for it. He volunteered that it was only because of Councilwoman Kehoe's repeated requests that the COS was released.

Mr. Langworthy was shown Exhibit 22, the October 6, 1999 memo from George Loveland to the Honorable Mayor and City Council re: "Water and Sewer Cost of Service Studies." He did not recall seeing the October 1999 memo.

Disclosure

Mr. Langworthy was shown Exhibit 23, an April 24, 2003 memo from City Attorney to Eric Adachi, Jenna Magan, and Bill Hanley re: "Revised POS for 2003 Sewer Revenue Bonds." Mr. Schachter asked Mr. Langworthy why he received this document. He said that Bromfield provided the document to Langworthy so that he could make sure parts relevant to him were accurate. He volunteered that he was generally familiar with disclosures. Mr. Schachter asked Mr. Langworthy why the noncompliance is not disclosed in Exhibit 21. He said page 3, first paragraph, does not mention noncompliance and there was no discussion regarding disclosing it. Mr. Schachter asked Mr. Langworthy if he knew how the "disallowed" language was put in the POS or why the word "annually" was changed to "periodically." He responded that he did not know. Mr. Schachter asked Mr. Langworthy if he was aware that grants and loans could be recalled for noncompliance. He said he was aware.

Mr. Schachter asked Mr. Langworthy about his involvement with the sewer Voluntary Disclosure. He said that he did not recall the Voluntary Disclosure being released and did not discuss potential liability with anyone.

Conclusion

Mr. Schachter asked Mr. Langworthy if he knew of anything illegal, improper or unethical occurring among City employees. Mr. Langworthy said everyone was looking out for the funds and were "never scheming." Mr. Schachter requested that Mr. Langworthy keep the interview confidential to maintain the integrity of the process and told him that if he recalled any new information or would like to change his answers, he should contact us.

June 28, 2006

On June 28, 2006, Mr. Langworthy contacted Mr. Shapiro by telephone regarding the issue of a loan provided to Kelco. Mr. Langworthy said that he recalled conversations with Mr. Hanley and others regarding the loan and recalled that the loan was paid back. He suggested that we contact Mr. Hanley or Marci Steier for more information. Mr. Langworthy also informed Mr. Shapiro that he had searched through his documents and could not find any documents discussing the loans to Kelco.

WF&G

3228955